LIONRIDGE
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Commentary

Keeping A Hand On A Solid Chair

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At a recent social function I participated in a game of musical chairs for the first time in many years. Everyone has a great time dancing until the music stops, and then there is the panicked scramble to grab a chair. Despite the short term fun and excitement there are many losers at the end, but it's just a game.

The latest round of market euphoria we've been witnessing reminds me of the later stages of a round of musical chairs. Investing, however, is not a game. Unfortunately it often seems that it's treated as one when market valuations get divorced from underlying fundamentals. As an example, a lot of money has flowed into index investments by way of the very popular exchange traded index funds. Stock markets have done well in recent years, so index funds have risen in value nicely, so more money is attracted to them despite the fact that many people buying them do not understand what they are actually investing in.

An equity portfolio, whether actively managed or tracking a broad index, is ultimately a collection of companies. Lionridge's job is to sort through the publicly traded companies to zero in on companies with strong fundamentals that are trading at attractive prices. Index funds by definition own a piece of every company in the index. So when you own an entire index, you own many companies that have characteristics that I seek to avoid. Right now indexes contain many overpriced stocks, as well as shares in companies that are not profitable, or have too much debt, or are badly managed, or operate in declining industries etc. It seems like a lot of the people who are dancing are not paying attention to the number of chairs available.

In the euphoria of the technology stock boom at the beginning of this century, many stocks were trading at ridiculously high valuations that turned out to be completly divorced from any underlying economic reality. And then the music stopped, and many people realized there weren't many chairs.

Marijuana stocks are another good example. The last time I studied their valuations was last March, when I was participating in an industry panel discussion on that topic. It appeared to me at that time that market valuations of these stocks were unreasonably high based on reasonable assumptions of future growth and profitability.

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It appeared that investors in these stocks were dancing around too few chairs. Since that time the price of these stocks have declined significantly - a major marijuana index fund has lost around half of its market value.

Although I don't try to engage in market timing, markets do appear quite overvalued in terms of valuation metrics I look at. More subjectively, the "Fear and Greed Index" tracked by CNN indicates that market sentiment is currently indicative of "extreme greed". The evidence I see of this is the continued dearth of opportunities to deploy the large cash position in our equity portfolios.

The stocks we own are attractively priced and have the potential to provide good long term returns from current levels, but new opportunities that fit my strict criteria are still hard to find. No major portfolio changes were made in the last quarter. Our cash position remains high at approximately one third of the Total Equity Portfolio, but as you know I remain patient if I can't find the right opportunities.

This discipline is a key part of my approach to risk management. I will deploy this cash in the right opportunities as and when they become available, but the right opportunities must meet my criteria of both quality and valuation. Protection of capital is a primary objective of Lionridge's investment philosophy. If you strapped a chair to yourself during a game of musical chairs, that would be cheating. It's different in the world of investing. When it comes to managing your money, I bring my own chair.

At Your Service,

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